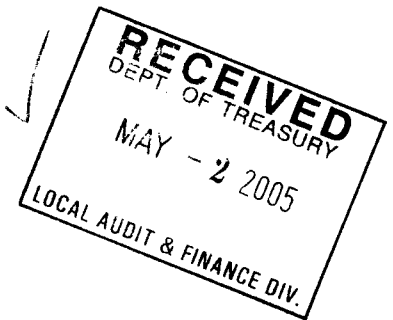


**FINANCIAL STATEMENTS
DECEMBER 31, 2004 AND 2003**



**DICKINSON
COUNTY
HEALTHCARE
SYSTEM**

22-7-511

(A COMPONENT UNIT OF DICKINSON COUNTY)

IRON MOUNTAIN, MICHIGAN

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name Dickinson County Healthcare System	County Dickinson
Audit Date 12/31/04	Opinion Date 4/6/05	Date Accountant Report Submitted to State:	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

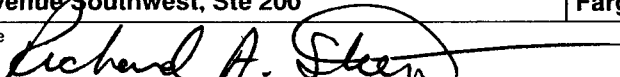
We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- ☐ Yes ☒ No 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☐ Yes ☒ No 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☐ Yes ☒ No 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- ☐ Yes ☒ No 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ Yes ☒ No 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ Yes ☒ No 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ Yes ☒ No 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ Yes ☒ No 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ Yes ☒ No 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).			✓

Certified Public Accountant (Firm Name) Eide Bailly LLP			
Street Address 3203 32nd Avenue Southwest, Ste 200		City Fargo	State ND
Accountant Signature 		ZIP 58103	Date 4/25/05

DICKINSON COUNTY HEALTHCARE SYSTEM

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**DICKINSON COUNTY HEALTHCARE SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2004 AND 2003**

Our discussion and analysis of Dickinson County Healthcare System's (Healthcare System's) financial performance provides an overview of financial activities for the fiscal years that ended on December 31, 2004 and 2003. Please read it in conjunction with the two-year comparative financial statements in this report.

This financial report is designed to provide our local citizens, customers, and creditors with a general overview of the System's finances and to demonstrate the System's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Healthcare System's Financial Offices, 1721 S. Stephenson Avenue, Iron Mountain, Michigan, 49801.

FINANCIAL HIGHLIGHTS

- The Healthcare System's net assets increased in 2004 by \$238 thousand, or 0.7% given operating income of \$1.7 million, non-operating expenses in excess of revenue of (\$1.6) million, and \$108 thousand of capital contributions. In 2003 the net asset increase was \$904 thousand or 2.8%.
- During 2004, the Healthcare System's total operating revenues increased to \$60.5 million or 2.9% over the \$58.8 million in 2003, while expenses increased to \$58.8 million or 4.6% over the \$56.2 million in 2003. The resulting operating income for 2004 was 2.8% of total operating revenue compared to 4.3% in 2003.
- Income before capital contributions was \$130 thousand compared to \$769 thousand in 2003. The non-operating investment income, excluding the unrealized amounts, decreased \$129 thousand in 2004 from the prior year's earnings due to reductions in investments for capital expenditures and slightly lower total returns. Interest expense decreased \$99 thousand due to principal payments. Other nonoperating revenue includes contributions and the loss on sale of capital items. Unrestricted general contributions were \$125 thousand in 2004 compared to \$33 thousand received in the prior year and the loss on the disposal of capital equipment was \$153 thousand less than that in 2003.
- During 2004 and 2003, the Healthcare System made the following significant expenditures on capital projects:
 - Installed a second CT scanner in 2004 and commenced construction of a major two-story addition to the DCMH facility to house a Fixed MRI and relocate rehabilitation services and other departments.
 - Completed the project to replace the General Financial, Materials Management and Human Resources systems in 2004.
 - Completed construction of a new access road and expanded parking for the Dickinson Medical Building and hospital employees in 2003.
 - Completed two clinic facilities in 2003 for which construction began in 2002.

The source of funding for these projects was derived from the proceeds of a \$5 million debt issue for construction, and from current and prior years' operations and capital contributions from the public through the Dickinson County Hospital Foundation. No government funding from taxes or any other source was used for capital or operating purposes.

REQUIRED FINANCIAL STATEMENTS

The Basic Financial Statements of the Healthcare System report information using accounting methods similar to those used by private sector companies. These statements offer short-term and long-term financial information about its activities and financial status.

The *Balance Sheet* includes all of the Healthcare System's assets, liabilities and net assets. It provides information about the nature and amounts of cash, receivables and investments in resources (assets) and the obligations to creditors (liabilities) at the end of each year presented. It also provides the basis for evaluating the debt and capital structure, and assessing the liquidity and financial flexibility of the Healthcare System. A summary table appears below.

All of the annual revenues and expenses are accounted for in the *Statement of Revenues, Expenses, and Changes in Net Assets*. These statements measures the annual financial performance of the Healthcare System's operations over the past two years and can be used to determine whether all of its paid and accrued costs have been covered by patient service revenue and other revenue sources that were received or receivable with an excess or a deficit for each year. A summary table of this statement is presented later in this discussion and analysis.

The final required financial statement is the *Statement of Cash Flows*. The primary purpose of this statement is to provide information about the Healthcare System's cash from operating, financing, and investing activities and the net change in cash balance during each of the two preceding annual periods.

FINANCIAL ANALYSIS OF THE SYSTEM

Table 1: Balance Sheet

The condensed balance sheets of the Healthcare System as of December 31, 2004 and 2003 is summarized in the following table.

CONDENSED BALANCE SHEETS DECEMBER 31, 2004 AND 2003 (in thousands)

	2004	2003
Total current assets (includes the current portion of restricted assets)	\$ 19,204	\$ 12,995
Cash and investments internally designated for capital acquisitions	10,748	13,783
Cash and investments internally designated for other purposes	1,404	1,359
Cash and investments restricted by bond indentures	5,416	2,394
Deferred financing costs, net	324	301
Capital assets, net	41,635	39,357
TOTAL ASSETS	\$ 78,731	\$ 70,189
Total current liabilities	\$ 11,352	\$ 6,858
Long-term debt, net of current portion	33,343	29,299
Other long-term liabilities	1,138	1,372
TOTAL LIABILITIES	45,833	37,529
TOTAL NET ASSETS	32,898	32,660
TOTAL LIABILITIES AND NET ASSETS	\$ 78,731	\$ 70,189

Current Assets and Liabilities:

Current Assets are principally comprised of cash and receivables. A major improvement in patient accounts receivable was accomplished in 2004 by reducing a backlog in completing medical records, which expedited billing. This resulted in a 21.5% decrease in the number of net days' revenue in accounts receivable to 40.5 at the end of 2004 from 51.6 at the end of 2003. Because of the reduction in accounts receivable in mid-year 2004, additional amounts of cash and investments are available as current assets to meet our current obligations.

Current liabilities increased significantly by \$4.5 million primarily due to the amount of estimated third-party settlements, which accounted for \$3.2 million of the increase. This increase is due to the fact that interim payments exceeded the amount that will ultimately be due under the reimbursement methodologies in effect for 2004 services by about \$1.6 million and this was recorded as a net payable. Whereas at the prior year-end, approximately \$1.3 million was estimated to be due to the Healthcare System (a net receivable) for 2003 services. The other net amounts included in the estimated settlement liability for each of the year-ends are provisions for adjustments to prior years' settlements that are still in the process of review and subject to adjustment by third-party payers and fiscal intermediaries. Adequate funds are available to settle these cost reports on the basis of management's estimates as they occur in future years.

Cash and Investments:

The 2004 number of days' cash on hand was 168.9. This is an increase from 125.2 at year-end 2003. This ratio shows how cash reserves compare to daily cash operating expenses plus interest expense. This includes the restricted funds of \$3.4 million expendable for debt service and the \$3.2 million of unexpended proceeds from an August 2004 debt issue. Excluding these amounts restricted by the revenue bond indentures, the ratios are 129.1 days and 102.9 days, respectively. Total cash and investments at year-end 2004 were \$27.9 million including the \$6.6 million of funds restricted for debt service and capital acquisitions by the bond indentures.

Long-Term Debt:

At year-end 2004, the Healthcare System had \$34.5 million in long-term debt (including current maturities of \$1.2 million). The Healthcare System issued Hospital Revenue Bonds, Series 2004, in the amount of \$5 million for the building addition presently under construction and due to open in July 2005 and for other capital projects to be completed in 2005 and 2006. The payments on the Series 2004 bond issue are made monthly with a 25-year repayment period. Long-term debt represents 96.7% of the System's total long-term liabilities and 75.4% of total liabilities at December 31, 2004 as compared to 95.5% and 81.0%, respectively, at December 31, 2003.

The debt service coverage ratio was 1.9 for 2004 compared to 1.9 for 2003. This ratio shows how the sum of income before capital contributions (adjusted for unrealized gains or losses on investments) plus depreciation and interest expense compares to the total of principal and interest payments on funded debt in the current year.

Components of Net Assets (in thousands):

	2004	2003
Invested in capital assets, net of related debt	\$ 7,096	\$ 8,968
Restricted by Revenue Bond Indentures, expendable for capital assets	3,220	-
Restricted by Revenue Bond Indentures, expendable for debt service	3,194	3,386
Unrestricted	19,388	20,306
Total net assets	\$ 32,898	\$ 32,660

The overall increase in net assets in 2004 is due to operating income and capital contributions. The \$5 million debt issuance in August 2004 is the principal cause of the decrease in the amount invested in capital minus all capital related debt. The restricted amount for capital asset acquisitions represents the unexpended portion of the proceeds from that debt issue. This amount will be spent for capital projects in 2005 and 2006. The restricted amount for debt service represents the funds held by the trustee for the Series 1999 bonds, and this amount decreased due to the reduction in the related debt service requirements. Unrestricted net assets decreased due to the purchase of capital assets and the required deposits to the restricted funds for debt service.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The condensed statements of revenues, expenses, and changes in net assets of the Healthcare System for the years ended December 31, 2004 and 2003 is summarized in the following table.

CONDENSED STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2004 AND 2003 (in thousands)

	2004		2003	
REVENUE AND (EXPENSES):				
Net patient service revenue	\$ 59,954	100.0%	\$ 58,178	100.0%
Other revenue	547	0.9%	593	1.0%
Total operating revenue	60,501	100.9%	58,771	101.0%
Total operating expenses	58,816	98.1%	56,241	96.7%
OPERATING INCOME	1,685	2.8%	2,530	4.3%
Investment income	730	1.2%	859	1.5%
Unrealized gains and losses on investments	(235)	-0.4%	(227)	-0.4%
Interest expense	(2,151)	-3.6%	(2,250)	-3.9%
Other non-operating revenue and expenses (net)	101	0.2%	(143)	-0.2%
Non-operating expenses in excess of revenue	(1,555)	-2.6%	(1,761)	-3.0%
INCOME BEFORE CAPITAL CONTRIBUTIONS	130	0.2%	769	1.3%
OTHER CHANGE IN NET ASSETS:				
Capital contributions	108		135	
Increase in net assets	238		904	
NET ASSETS - BEGINNING OF YEAR	32,660		32,660	
NET ASSETS - END OF YEAR	\$ 32,898		\$ 33,564	

Sources of Financial Support:

The Healthcare System relies upon its revenues and public contributions received directly or through the Dickinson County Hospital Foundation for 100% of its financial support. No tax revenue is received either directly from local taxpayers or through fund transfers from Dickinson County or other governments. Revenue is comprised of operating revenue, which is principally from healthcare services and nonoperating revenue which is principally from investment income.

Operating Revenue:

Net patient revenue is reported as the result of subtracting estimated contractual allowances, provisions for charity care and bad debts from gross revenue recorded at our established rates. Total gross revenue for all patient services performed by the Healthcare System was \$132.3 million in 2004 and \$126.0 million in 2003. This overall increase includes the impact of price increases of 9% for hospital services and 5% for physician practices on January 1, 2004. The 5.0% total increase in gross charges also reflects the year-to-year differences in patient volumes, as presented in the Operating Results discussion in a later section. Gross revenue is based upon the services provided at our established rates. To the extent the Healthcare System receives payment under fixed rates by third-party payers as explained below, the price increase has a diminished effect on net patient revenue.

The services performed under contractual arrangements with Medicare, Michigan Medicaid, Blue Cross Blue Shield of Michigan and other contractual payers are recorded on the day of service at the established charges of the Healthcare System. In order to determine net patient service revenue, provisions for contractual allowances are recorded to recognize deductions from revenue resulting from contractual allowances under various reimbursement arrangements. These provisions, including adjustments for prior years' settlements, give rise to the amount included in current liabilities as a net payable, which increased significantly in 2004.

Management maintains systems and procedures to administer and comply with the payment contracts and files cost reports on an annual basis. The reimbursement methods include payer audits and reviews of cost reports and individual claims that sometimes result in adjustments to amounts previously paid, additional payments, or denial of payment. Management applies estimates to provide for these payments and adjustments, and it continually reviews and adjusts those estimates until all reimbursement for a given year has been finalized.

The Healthcare System provides care without regard to the ability to pay. Free or reduced-rate care is provided based on family income. In 2004 and 2003, the Healthcare System deducted approximately 0.7% and 0.5%, respectively, from its gross charges for services provided to patients who documented their inability to pay. Collection efforts are pursued if the bills for services are not paid and qualification for free or reduced-rate care has not been established. Some portion of the resulting bad debt adjustment also includes free care to persons who would have qualified for free or reduced-rate care had they provided documentation of income.

Bad debt provisions were 2.3% of gross charges in 2004 and 2.5% in 2003. Management estimates the allowance for doubtful accounts by applying percentages to an aged trial balance of accounts collectible from patients, and includes provisions to account for balances currently due from insurance companies that may be subsequently denied.

The resulting net patient services revenue was 45.3% of gross revenue in 2004 and 46.2% in 2003. Net patient service revenue for 2004 increased \$1.8 million or 3.1% from 2003 due to the remaining net effect of the price increase, net improvement in third-party payment rates, the additional payments for prior years' cost report settlements and the slight decline in overall patient volumes as presented in the Operating Performance section of this discussion.

Nonoperating Revenue:

Investment income from interest for was \$730 thousand for 2004 and \$859 thousand for 2003. The decrease is due to the use of investments for capital expenditures and lower returns. Interest is earned on fixed-income securities and money market accounts. All cash in excess of daily operating requirements is invested. The investment manager considers the cash flow budgets and plans of the Healthcare System as well as the underlying market conditions in decisions to purchase and sell bonds issued by or backed by the full faith and credit of the United States of America. Management and the Board of Trustees monitor the investment manager performance. The bond portfolio presently held has a conservative duration, and management does not foresee a need to sell any of the bonds at a loss. However, the investments are adjusted to market value, and the resulting unrealized gain or loss is reflected in the present period. The unrealized losses on investments were \$235 thousand in 2004 and \$227 thousand in 2003.

Capital Contributions:

Fiscal year 2004 capital contributions of \$108 were received for emergency department equipment and a laboratory information system component. Fiscal year 2003 capital contributions of \$135 thousand consist of donations to the Healthcare System for improvements to the new access road to the main facility and for radiology equipment acquisitions.

Operating Expenses:

The components of operating expenses for Dickinson County Healthcare System for the years ended December 31, 2004 and 2003 is summarized in the following table:

**COMPONENTS OF OPERATING EXPENSES
FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003 (in thousands)**

	2004	2003	Increase/ (Decrease)	
Salaries, wages and employee benefits	\$ 37,325	\$ 34,669	\$ 2,656	7.7%
Supplies and pharmaceuticals	7,787	8,830	(1,043)	-11.8%
Professional fees and other purchased services	10,290	9,424	866	9.2%
Depreciation and amortization	3,414	3,318	96	2.9%
Total	58,816	56,241	\$ 2,575	4.6%

Employee compensation and benefits increased \$2.7 million or 7.7%. Salaries and wages increased by \$1.4 million or 5.3%. Total paid hours per adjusted discharge were 105.2 in 2004 and 108.6 in 2003, a reduction of 3.1%. Total full-time equivalent positions decreased by 1.4%. Salaries and wages per full-time equivalent position was \$46,384 in 2004, an increase of 6.8% from 2003. Two Unions represent approximately 64% of total employees. The contracts expire in May 2005 and December 2006. Union negotiations are underway on the agreement that expires in 2005 and are expected to be resolved in a satisfactory manner. Employee benefit costs were 32.5% of salaries and wages in 2004 and 29.7% in 2003. Benefit costs increased 15.5% overall with health insurance, a major component, increasing least of all at 7.2%, while the cost of paid time off and workers compensation contributed above average increases. Salaries, wages, and benefits have been maintained on a competitive basis, and no critical shortages of labor have been experienced.

The cost of supplies and pharmaceuticals decreased \$1.0 million or 11.8%. This was due to the reduction in patient volumes.

Professional fees, purchased services, and other expenses for 2004 increased \$866 thousand or 9.2%. Significant increases included the following areas where fees were higher than in 2003: temporary coverage by orthopedic physicians increased \$238 thousand, cost of professional liability claims deductibles increased \$150 thousand and advertising expenses increased \$107 thousand.

Non-operating Expense Items:

Interest expense was \$2.2 million in 2004 and \$2.3 million in 2003. Interest expense decreased slightly due to payment of current maturities on long-term debt as shown in the *Statement of Cash Flows*.

The Healthcare System realized losses on equipment disposals of \$24 thousand in 2004 and \$176 thousand in 2003 related to sales of capital assets, equipment trade-ins and minor adjustments to property records. These losses are netted with other minor non-operating revenue and expenses.

Capital Expenditures:

In 2004, the Healthcare System broke ground on a new building addition to the front of the Dickinson County Memorial Hospital facility. The two-story addition will house a new fixed MRI unit that replaces the present mobile unit and provide expanded space for physical rehabilitation services, permitting consolidation of its cardiac rehabilitation program presently housed in the Dickinson Medical Building. The estimated cost to complete construction at December 31, 2004 was \$2.5 million, and the project is expected to be completed in July of 2005 at a cost of \$3.9 million. No other commitments have been made for other planned and budgeted renovation projects.

Major medical and information technology projects that commenced in 2004 included the addition of a multi-slice CT scanner at a cost of \$988 thousand that became operational in May of 2004 and a Picture Archive Computer System (PACS) and Radiology Information System (RIS) commenced in September, 2004 and will be completed in September of 2005 at a cost upon completion of approximately \$1.4 million. The enterprise resource procurement system from Lawson replaced components of the present hospital information system in the areas of materials management, human resources and fiscal services in 2004 at a cost of \$1.8 million incurred over a two and one-half year period.

OPERATING RESULTS

The following summarizes the operating results of the Healthcare System and its business units as reflected in the Statements of Revenue, Expenses, and Changes in Net Assets between 2004 and 2003:

Dickinson County Healthcare System:

The overall activity of the Healthcare System, as measured by patient discharges adjusted for outpatient services and all other patient revenue, was relatively flat at 12,008 adjusted discharges for 2004 compared to 11,795 adjusted discharges in 2003. This was an increase of 1.8%. The adjusted discharge statistic is used as the means to measure the overall activity volume of the Healthcare System. Patient revenue before the bad debt provision per adjusted discharge was \$5,241 in 2004, a 0.7% increase from 2003. Operating expenses including the bad debt provision per adjusted discharge was \$5,146 in 2004, a 2.1% increase from 2003. Improvements in productivity and a decrease in supplies and pharmaceuticals helped control expenses relative to patient volumes, while fixed costs had an adverse effect resulting in a decrease in operating income for 2004.

Dickinson County Memorial Hospital:

Inpatient activity levels at the Dickinson County Memorial Hospital (DCMH) facility for 2004 comprised about 36.4% of net patient revenue of the Healthcare System. Total patient days and discharges of acute inpatients were 15,318 and 4,043, respectively in fiscal year 2004. This is a decrease of 11.3% and 4.7%, respectively, from fiscal year 2003. The larger percentage change in patient days than in discharges is indicative of the success of the project to lower average length of stay discussed under a following section of this analysis.

Total outpatient visits at DCMH were 148,967, or 1.0% below 2003 levels, the third year of decline in a row after dramatic annual growth rates through 2001 since the new facility opened in 1996. Outpatient surgery was the most dramatic area of decline, showing a 9.3% decrease in visits in 2004. DCMH outpatient services are approximately 53.5% of patient revenue of the Healthcare System and contribute a positive contribution margin toward operating income.

Physician Services and Other Operating Units:

Total visits to physicians at the Healthcare System's clinics and physician practices were at 38,885, or 4.1% below 2003 levels. In total, the Physician Services component unit contributes slightly more than 5.1% of patient revenue of the Healthcare System. The clinic and physician practice expenses exceeded their operating revenue.

Dickinson Home Health (DHH) saw 354 patients in 2004, or 6.0% more than 2003 levels. The increase was due to activities at senior fairs and other community events and other management actions to increase awareness of the service among both our medical staff and the community, and to promote a favorable and consistent image in the service area. Dickinson Home Medical Equipment (DHME), which shares the location and management of DHH operations, also increased total revenue in 2004 as a result of increased community awareness and from efforts to establish agreements with extended care facilities to provide oxygen and related equipment to their clients. On a combined basis, these activities contributed to operating income in both 2004 and 2003, and they comprise slightly more than 2.9% of patient revenue of the Healthcare System.

The Upper Peninsula Sleep Center contributes 1.0% of net patient revenue of the Healthcare System and contributed to income in both years. The DCHS unit is the only certified sleep center in the upper peninsula of Michigan, and was staffed by four certified diagnostic technologists in 2004.

Operations Improvement and Strategic Planning:

Management successfully carried out projects to decrease the average length of stay and to improve physician documentation that had a successful impact on operations in 2004. The ongoing physician recruitment for necessary specialties such as orthopedics and urology and the longer-term planning for primary care physician transition and retirements also received primary attention in 2004. The Board and management are seeking ways to increase market share for the Healthcare System and area physicians through joint planning.

The quality management program to improve inpatient case management reduced lengths of stay by 7.3% and avoided unnecessary consumption of hospital resources while maintaining good outcomes and patient satisfaction. Benchmarks were determined for length of stay and utilization of ancillaries using an external database. Overall cost per discharge was under better control, and, to the extent our reimbursement is based upon a fixed rate per case, as with Medicare and Michigan Medicaid, net revenue will not be affected.

An outside consultant was used to audit physician documentation and work with the medical staff to improve terminology and documentation of diagnoses. An internal physician reviewer and a medical records coder have been trained to continue the audit process under periodic review by the outside consultant. The project began in August of 2003. The baseline Medicare case mix index prior to inception of the project was 1.15 compared to the full-year averages of 1.26 for 2004 and 1.19 for 2003. This resulted in additional reimbursement of \$1.1 million in 2004 and \$360 thousand in 2003.

The Healthcare System is a member of the Upper Peninsula Healthcare Network (UPHCN) along with Marquette General Health System whose interests are aligned to help retain primary care in Dickinson County and meet the tertiary care needs of that market within Michigan. The Upper Peninsula Health Plan (UPHP) is owned by UPHCN members and has developed an alliance with Blue Cross Blue Shield of Michigan to provide a network of Michigan providers. The Healthcare System has begun to use that network for its employee health plan, and intends to work with UPHP to provide a cost savings opportunity to other Michigan employers. Management has determined that significant market share improvement is possible if patients in its primary service area stayed in Michigan for services.

CURRENT BUDGET

As required by the Bylaws, Management prepares an annual budget for the approval of the Board of Trustees of the Healthcare System. The Current Budget as approved consists of an operating budget, a cash flow budget and a three-year capital budget together with any capital financing plans. The operating budget is presented in a format similar to the *Statements of Revenues, Expenses, and Changes in Net Assets* (except that the provision for bad debts is budgeted as an operating expense instead of as a reduction from revenue) and the cash flow budget is submitted in a format similar to the *Statement of Cash Flows*. Operating statistics that serve as assumptions underlying the financial amounts in the budgets are also budgeted. On a monthly basis, actual financial and statistical amounts are compared to budgeted amounts and variances are monitored and controlled.

CONDENSED STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS ACTUAL COMPARED TO BUDGET YEAR ENDED DECEMBER 31, 2004 (in thousands)

	Actual	Budget	Variance*	
REVENUE AND (EXPENSES):				
Net patient service revenue	\$ 62,937	\$ 65,893	\$ (2,956)	-4.5%
Other	547	543	4	0.7%
Total operating revenue	63,484	66,436	(2,952)	-4.4%
Total operating expenses	61,799	63,486	1,687	2.7%
OPERATING INCOME	1,685	2,950	(1,265)	-42.9%
Investment income	730	840	(110)	-13.1%
Unrealized gains and losses on investments	(235)	Not Budgeted	(235)	NA
Interest expense	(2,151)	(2,209)	58	2.6%
Other non-operating revenue and expenses (net)	101	5	96	1920.0%
Non-operating expenses in excess of revenue	(1,555)	(1,364)	(191)	-14.0%
INCOME BEFORE CAPITAL CONTRIBUTIONS	130	1,586	(1,456)	-91.8%
OTHER CHANGE IN NET ASSETS:				
Capital contributions	108	35	73	208.6%
Increase in net assets	238	1,621	(1,383)	-85.3%
NET ASSETS - BEGINNING OF YEAR	32,660	32,660		
NET ASSETS - END OF YEAR	\$ 32,898	\$ 34,281	\$ (1,383)	-4.0%

*In the variance column of this table, a negative value (-) indicates an unfavorable variance to budget.

Net patient revenue was under budget by \$3 million or 4.5%. The budget assumed no change in inpatient volumes from 2003, and an increase in outpatient visits of approximately 1.6%, whereas inpatient volumes decreased 11.3% and outpatient volumes decreased by 1.0%. The projects to decrease average length of stay and improve physician documentation for better reimbursement were successful in curtailing the impact on the budget of the inpatient volume decrease. Overall physician services revenue was at a constant level with 2003, but the 2004 budget assumed an increase of 3.2%.

Investment income was under budget \$110 thousand. The budget assumed a slightly higher interest rate than was actually earned. Interest expense was under budget due to borrowing later in the year than the budget assumed and more interest expense was capitalized than the budget assumed. Other non-operating revenue was favorable due to more grants and contributions than the budget assumed.

**COMPONENTS OF OPERATING EXPENSES
ACTUAL COMPARED TO BUDGET
YEAR ENDED DECEMBER 31, 2004 (in thousands)**

	Actual	Budget	Variance*	
Salaries, wages and employee benefits	\$ 37,325	\$ 37,799	\$ (474)	-1.3%
Supplies and pharmaceuticals	7,787	8,254	(467)	-5.7%
Professional fees and other purchased services	10,290	10,077	213	2.1%
Depreciation and amortization	3,414	3,520	(106)	-3.0%
Provisions for bad debts	2,983	3,836	(853)	-22.2%
Total	<u>\$ 61,799</u>	<u>\$ 63,486</u>	<u>\$ (1,687)</u>	<u>-2.7%</u>

*In the variance column of this table, a negative value (-) indicates a favorable variance to budget.

Employee compensation and benefit expense was under budget \$474 thousand in total or 1.3%, with the salaries and wages component coming in under budget and employee benefits slightly over budget. Management anticipates the need to maintain employee compensation in line with market forces in the future given the need to continue to recruit and retained a highly skilled labor force.

Supplies and pharmaceuticals were under budget \$467 thousand or 5.7%, primarily due to lower inpatient and outpatient surgery volumes than had been anticipated in the budget.

Professional fees and other purchased services were over budget principally due to expenses relating to professional and general liability claims deductibles, which contributed \$156 thousand of the unfavorable variance

The provision for bad debts was under budget \$853 thousand or 22.2%. The provision is budgeted as a function of gross charges, which were \$5.4 million or 3.9% under budget. The budget assumed 2.8% of gross charges for the provision, and the actual came in at 2.3% of gross charges.

CAPITAL BUDGET AND FINANCIAL PLAN

The capital budget planned for 2004 capital expenditures of \$8.4 million and included the two-story addition to accommodate a fixed site MRI (the equipment is budgeted for 2005) and consolidation of rehabilitation services, all in a new addition to the front of the DCMH facility. It also reflected the plans to replace the hospital information system and to move toward filmless medical imaging in the radiology department. The Hospital Revenue Bonds, Series 2004 that were issued in August 2004 in the amount of \$5 million were for the hospital addition and other construction projects.

Actual capital spending was \$5.5 million. There were no projects over budget. The principal amounts budgeted but not spent were for the replacement hospital information system and the new PACS/RIS systems, both of which were in contract negotiations at year-end, and other IT projects.

The two-story addition project is expected to be completed on budget in July of 2005 at a cost of \$3.9 million. Of the total project cost \$1.4 million was completed as of December 31, 2004.

The multi-slice CT scanner equipment acquisition was completed in 2004 at a cost of \$988 thousand, as budgeted.

INDEPENDENT AUDITOR'S REPORT

The Board of Trustees
Dickinson County Healthcare System
Iron Mountain, Michigan

We have audited the accompanying balance sheet of **Dickinson County Healthcare System** (a component unit of Dickinson County) as of December 31, 2004, and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Healthcare System's management. Our responsibility is to express an opinion on these financial statements based on our audit. The 2003 financial statements were audited by other auditors whose report dated April 2, 2004 expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only **Dickinson County Healthcare System** and are not intended to present fairly the financial position of Dickinson County, Michigan, and do not reflect the results of its operations and cash flows of its proprietary funds in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **Dickinson County Healthcare System** as of December 31, 2004, and the results of its operations, changes in net assets, and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 1 through 11 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on management's discussion and analysis.

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In accordance with *Government Auditing Standards*, we have also issued our report dated April 6, 2005, on our consideration of **Dickinson County Healthcare System**'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Eide Bailly LLP

Fargo, North Dakota
April 6, 2005

DICKINSON COUNTY HEALTHCARE SYSTEM**(A Component Unit of Dickinson County)****BALANCE SHEETS****DECEMBER 31, 2004 AND 2003**

	<u>2004</u>	<u>2003</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 6,186,447	\$ 1,273,202
Temporary investments	3,008,435	35,850
Current portion of restricted assets	1,171,950	1,174,273
Receivables		
Patient, net of estimated uncollectibles of		
\$2,035,000 in 2004 and \$2,252,000 in 2003	6,969,137	8,670,753
Other	482,355	158,503
Supplies and other current assets	1,385,439	1,682,517
Total current assets	<u>19,203,763</u>	<u>12,995,098</u>
NONCURRENT CASH AND INVESTMENTS		
Internally designated for capital improvements	10,748,216	13,768,198
Other long-term investments	1,404,263	1,374,113
Restricted under indenture agreement for debt service	2,195,456	2,393,584
Restricted under indenture agreement for capital assets	3,220,328	-
Total assets limited as to use	<u>17,568,263</u>	<u>17,535,895</u>
CAPITAL ASSETS	<u>41,635,173</u>	<u>39,356,767</u>
DEFERRED FINANCING COSTS, net accumulated amortization		
of \$139,729 in 2004 and \$115,954 in 2003	323,885	301,414
Total assets	<u>\$ 78,731,084</u>	<u>\$ 70,189,174</u>

See Notes to Financial Statements

	2004	2003
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current maturities of long-term debt	\$ 1,195,998	\$ 1,090,469
Accounts payable		
Trade	1,790,886	1,602,700
Construction and capital assets	348,811	35,850
Estimated third-party payor settlements	3,597,957	414,886
Accrued expenses		
Salaries, wages, and related liabilities	1,214,030	840,206
Compensated absences	2,446,690	2,240,438
Other accrued liabilities	460,437	329,592
Interest	296,950	304,273
Total current liabilities	11,351,759	6,858,414
LONG-TERM LIABILITIES		
Long-term debt, less current maturities	33,342,948	29,298,451
Reserve for loss on general and professional liabilities claims	965,000	1,190,000
Other	173,570	182,320
Total long-term liabilities	34,481,518	30,670,771
Total liabilities	45,833,277	37,529,185
NET ASSETS		
Invested in capital assets, net of related debt	7,096,227	8,967,847
Restricted - expendable for debt service	3,193,836	3,385,537
Restricted - expendable for capital assets	3,220,328	-
Unrestricted	19,387,416	20,306,605
Total net assets	32,897,807	32,659,989
Total liabilities and net assets	\$ 78,731,084	\$ 70,189,174

DICKINSON COUNTY HEALTHCARE SYSTEM**(A Component Unit of Dickinson County)****STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2004 AND 2003**

	<u>2004</u>	<u>2003</u>
OPERATING REVENUE		
Net patient service revenue, net of provision for bad debts of of \$2,982,798 in 2004 and \$3,188,121 in 2003	\$ 59,954,291	\$ 58,178,318
Other revenue	<u>547,336</u>	<u>592,996</u>
Total operating revenue	<u>60,501,627</u>	<u>58,771,314</u>
OPERATING EXPENSES		
Salaries and wages	28,159,625	26,730,879
Employee benefits	9,165,630	7,937,597
Supplies and pharmaceuticals	7,787,076	8,830,428
Medical and other professional fees	5,285,582	4,965,054
Purchased services and other	5,004,824	4,458,753
Depreciation and amortization	<u>3,413,627</u>	<u>3,318,428</u>
Total operating expenses	<u>58,816,364</u>	<u>56,241,139</u>
OPERATING INCOME	<u>1,685,263</u>	<u>2,530,175</u>
NONOPERATING REVENUES (EXPENSES)		
Unrestricted general contributions and other	125,453	33,473
Interest expense	(2,150,694)	(2,250,543)
Loss on disposal of capital assets	(23,628)	(176,010)
Investment income	729,375	859,177
Change in unrealized gains and losses on investments	<u>(235,451)</u>	<u>(227,720)</u>
Total nonoperating revenues (expenses)	<u>(1,554,945)</u>	<u>(1,761,623)</u>
REVENUES IN EXCESS OF EXPENSES BEFORE CAPITAL CONTRIBUTIONS	130,318	768,552
CAPITAL CONTRIBUTIONS	<u>107,500</u>	<u>134,968</u>
INCREASE IN NET ASSETS	237,818	903,520
NET ASSETS, BEGINNING OF YEAR	<u>32,659,989</u>	<u>31,756,469</u>
NET ASSETS, END OF YEAR	<u>\$ 32,897,807</u>	<u>\$ 32,659,989</u>

DICKINSON COUNTY HEALTHCARE SYSTEM**(A Component Unit of Dickinson County)****STATEMENTS OF CASH FLOWS****YEARS ENDED DECEMBER 31, 2004 AND 2003**

	<u>2004</u>	<u>2003</u>
OPERATING ACTIVITIES		
Receipts from and on behalf of patients	\$ 64,838,978	\$ 57,562,499
Payments to suppliers and contractors	(26,645,751)	(26,687,321)
Payments to employees	(27,785,801)	(26,617,664)
Other receipts and payments	223,484	552,704
NET CASH FROM OPERATING ACTIVITIES	<u>10,630,910</u>	<u>4,810,218</u>
NONCAPITAL FINANCING ACTIVITIES		
Unrestricted general contributions and other	125,453	33,474
CAPITAL AND CAPITAL RELATED FINANCING ACTIVITIES		
Purchase of capital assets, net	(5,326,470)	(3,297,141)
Proceeds from issuance of Series 2004 bonds	5,000,000	-
Repayment of long-term debt	(1,121,128)	(1,107,655)
Interest paid, including capitalized interest	(1,961,903)	(1,955,437)
Payment of deferred financing costs	(46,246)	-
Capital contributions	107,500	134,968
Proceeds from the sale of capital assets	22,585	106,583
NET CASH USED FOR CAPITAL AND CAPITAL RELATED FINANCING ACTIVITIES	<u>(3,325,662)</u>	<u>(6,118,682)</u>
INVESTING ACTIVITIES		
Purchases of investments	(5,222,936)	(13,491,094)
Proceeds from sales and maturities of investments	2,212,322	15,388,928
Investment income	729,375	859,177
Change in unrealized gains and losses on investments	(235,451)	(227,720)
NET CASH FROM (USED FOR) INVESTING ACTIVITIES	<u>(2,516,690)</u>	<u>2,529,291</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	4,914,011	1,254,301
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>1,288,271</u>	<u>33,970</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 6,202,282</u>	<u>\$ 1,288,271</u>
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE BALANCE SHEETS		
Cash and cash equivalents in current assets	\$ 6,186,447	\$ 1,273,202
Cash and cash equivalents in other long-term investments	15,835	15,069
Total cash and cash equivalents	<u>\$ 6,202,282</u>	<u>\$ 1,288,271</u>

(continued on next page)

STATEMENTS OF CASH FLOWS - page 2

	2004	2003
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	\$ 1,685,263	\$ 2,530,175
Adjustments to reconcile operating income to net cash flows from operating activities		
Depreciation and amortization	3,413,627	3,318,428
Provision for bad debts	2,982,798	3,188,121
Changes in assets and liabilities		
Patient receivables, net of provision for bad debts	(1,281,182)	(4,000,409)
Other receivables	(323,852)	(40,292)
Supplies and other current assets	297,078	(453,862)
Accounts payable - trade	188,186	58,860
Estimated third-party payor settlements	3,183,071	196,469
Accrued expenses	710,921	172,728
Reserve for loss on general and professional liabilities claims	(225,000)	(160,000)
NET CASH FROM OPERATING ACTIVITIES	<u>\$ 10,630,910</u>	<u>\$ 4,810,218</u>

DICKINSON COUNTY HEALTHCARE SYSTEM

(A Component Unit of Dickinson County)

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2004 AND 2003

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization

Dickinson County Healthcare System (Healthcare System) was formed as a county public Healthcare System in 1947. It was created to operate, control and manage all matters concerning Michigan's Dickinson County healthcare function. In 1990, the county public Healthcare System was reorganized as a health facilities corporation under Act 230 and assumed all rights, privileges, immunities and franchise of the predecessor county public Healthcare System. The Healthcare System provides acute, ambulatory, home health and certain physician services to the residents of its service area. The Board of County Commissioners approves the members of the Board of Trustees of the Healthcare System. The Healthcare System may not issue long-term debt without the County's approval. The Healthcare System is considered to be a component unit of Dickinson County.

The current Healthcare System facility was completed in 1996 on land leased from Dickinson County (County) under a one hundred year lease. Under provisions of the lease, title and ownership of all buildings and improvements constructed on the site are in the name of County. The lease places certain requirements and restrictions on the Healthcare System.

Dickinson County Healthcare System is accounted for as an enterprise fund of the County. The Healthcare System is exempt from federal and state income taxes under Section 115 of the Internal Revenue Code.

These financial statements include only the activity of the Healthcare System.

Enterprise Fund Accounting

The Healthcare System uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Healthcare System has adopted the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

The financial statements have been presented in conformity with generally accepted accounting principles as promulgated by GASB and as recommended in the Audit and Accounting Guide for Health Care Organizations published by the American Institute of Certified Public Accountants.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments, unless otherwise designated or restricted, with an original maturity of three months or less when acquired.

(continued on next page)

NOTES TO FINANCIAL STATEMENTS

Temporary Investments

Temporary investments include investments with an average maturity of three to twelve months, excluding internally designated and restricted cash and investments and other long-term investments. Temporary investments are recorded at fair value.

Patient Receivables

Patient receivables are uncollateralized patient and third-party payor obligations. Payments of patient receivables are allocated to the specific claims identified on the remittance advice or, if unspecified, are applied to the earliest unpaid claim.

The carrying amount of patient receivables is reduced by a valuation allowance that reflects management's estimate of amounts that will not be collected from patients and third-party payors. Management reviews patient receivables by payor class and applies percentages to determine estimated amounts that will not be collected from third parties under contractual agreements and amounts that will not be collected from patients due to bad debts. Management considers historical write off and recovery information in determining the estimated bad debt provision.

Supplies

Supplies are stated at lower of cost (first-in, first-out) or market.

Investments and Investment Income

Investments in debt and equity securities are reported at fair value. Fair value is determined based on quoted market prices, if available or estimated fair value using quoted market prices for similar securities. Interest, dividends, gains and losses, both realized and unrealized, on investments in debt and equity securities are included in nonoperating revenues when earned.

Internally designated funds consist primarily of U.S. Treasury securities and money market funds. Funds restricted under indenture agreement for debt service consists of a debt service reserve fund and principal and interest funds and are invested primarily in U.S. Treasury securities with maturities that match planned expenditures. Funds restricted under indenture agreement for capital assets are invested primarily in money market and U.S. Treasury securities.

Fund that are available for obligations classified as current liabilities are reported in current assets.

Capital Assets

Capital asset acquisitions in excess of \$1,000 are capitalized and recorded at cost. Contributed capital assets are reported at their estimated fair value at the time of their donation. All capital assets other than land are depreciated or amortized (in the case of capital leases) using the straight-line method of depreciation using these asset lives:

Land improvements	5-20 years
Buildings and improvements	5-40 years
Equipment	3-20 years

NOTES TO FINANCIAL STATEMENTS

Costs of Borrowing

Except for capital assets acquired through gifts, contributions, or capital grants, interest cost on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The Healthcare System capitalized \$98,815 of interest cost in 2004.

Deferred Financing Costs

Deferred financing costs are amortized over the period the related obligation is outstanding using the bonds-outstanding method.

Compensated Absences

The Healthcare System has a paid-time-off (PTO) program that allows employees to earn vacation and catastrophic leave (CAT) benefits based, in part, on length of service. Employees may accumulate PTO up to a specified maximum. Employees are paid for accumulated PTO if employment is terminated. The PTO program also allows for 25% of accumulated CAT days to be paid out at retirement up to a maximum of 120 hours. CAT days not paid out are applied to years of service for pension credit calculations.

Grants and Contributions

From time to time, the Healthcare System receives grants and contributions. Revenues from grants and contributions (including contributions of capital assets) are recognized as revenue when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

Restricted Resources

When the Healthcare System has both restricted and unrestricted resources available to finance a particular program, it is the Healthcare System's policy to use restricted resources before unrestricted resources.

Net Assets

Net assets are presented in the following three components

Net Assets Invested in Capital Assets, Net of Related Debt - Invested in capital assets net of related debt consist of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets.

Restricted Expendable Net Assets - Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditor, grantors, or contributors external to the Healthcare System, including amounts deposited with trustees as required by bond indenture agreements.

Unrestricted Net Assets - Unrestricted net assets are remaining net assets that do not meet the definition of "Invested in Capital Assets Net of Related Debt" or "Restricted."

NOTES TO FINANCIAL STATEMENTS

Net Patient Service Revenue

The Healthcare System has agreements with third-party payors that provide for payments to the Healthcare System at amounts different from its established rates. Payment arrangements include prospectively determined rates, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Operating Revenues and Expenses

The Healthcare System's statements of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services - the Healthcare System's principal activity. Nonexchange revenues, including grants and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Charity Care

To fulfill its mission of community service, the Healthcare System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Healthcare System does not pursue collection of amounts determined to qualify as charity care, they are not reported as patient service revenue (Note 3).

Advertising Costs

The Healthcare System expenses advertising costs as incurred.

Risk Management

The Healthcare System is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Reclassifications

Certain items in the prior year financial statements have been reclassified for comparability purposes with the current year financial statements. These reclassifications did not affect the financial position or results of operations as previously reported.

NOTES TO FINANCIAL STATEMENTS

NOTE 2 - CHARITY CARE

The Healthcare System maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy and equivalent service statistics. The amounts of charges foregone, based on established rates, were \$881,315 and \$593,072 for the years ended December 31, 2004 and 2003.

NOTE 3 - NET PATIENT SERVICE REVENUE

The Healthcare System has agreements with third-party payors that provide for payments to the Healthcare System at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare: Inpatient acute care and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per visit. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. The Healthcare System's Medicare cost reports have been settled by the Medicare fiscal intermediary through the year ended December 31, 2001. The Healthcare System's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Healthcare System.

Medicaid. Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Defined capital costs are paid based on a cost reimbursement methodology for inpatient services. Outpatient services related to Medicaid program beneficiaries are reimbursed on a fee for service basis. The Healthcare System's Medicaid cost reports have been settled by the Medicaid fiscal intermediary through December 31, 1997.

Blue Cross. Inpatient and outpatient services rendered to Blue Cross subscribers are paid on a cost related methodology with final settlement determined after submission of annual cost reports by the Healthcare System and are subject to audits thereof by Blue Cross. The Healthcare System's Blue Cross cost reports have been settled by Blue Cross through December 31, 2000.

The Healthcare System has also entered into payment agreements with certain commercial insurance carriers and other organizations. The basis for payment to the Healthcare System under these agreements includes prospectively determined rates per discharge and discounts from established charges.

NOTES TO FINANCIAL STATEMENTS

Laws and regulations governing the Medicare, Medicaid, and other programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

A summary of patient service revenue, contractual adjustments, and provision for bad debts for the years ended December 31, 2004 and 2003 is as follows:

	2004	2003
Gross patient service revenue	\$ 132,314,546	\$ 126,017,195
Less: charity care	(881,315)	(593,072)
Total patient service revenue	131,433,231	125,424,123
Contractual adjustments		
Medicare	(33,326,973)	(32,549,703)
Medicaid	(9,095,741)	(7,820,193)
Blue Cross	(19,268,109)	(18,378,771)
Other	(6,805,319)	(5,309,017)
Provision for bad debts	(68,496,142)	(64,057,684)
	(2,982,798)	(3,188,121)
Total contractual adjustments and provision for bad debts	(71,478,940)	(67,245,805)
Net patient service revenue	\$ 59,954,291	\$ 58,178,318

NOTE 4 - DEPOSITS AND INVESTMENTS

Deposits and investments

Michigan Compiled Laws, Section 129.91, authorizes the Healthcare System to deposit and invest in accounts of federally insured banks, credit unions, and savings and loan associations which have an office in Michigan. The Healthcare System is allowed to invest in bonds, securities and other direct obligations of the United States or any agency or instrumentality of the United States; United States government or federal agency obligations; repurchase agreements; banker's acceptance of United States banks; commercial paper rated within the two highest classifications which mature not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions which are rated as investment grade; and mutual funds composed of investment vehicles which are legal for direct investment by local units of government in Michigan. The Healthcare System's deposits and investments are in accordance with statutory authority.

NOTES TO FINANCIAL STATEMENTS

At year end the Healthcare System's deposits and investments were reported in Healthcare System's balance sheets as follows:

	2004	2003
Cash and cash equivalents	\$ 6,186,447	\$ 1,273,202
Temporary investments	3,008,435	35,850
Restricted assets - current portion (Note 7)	1,171,950	1,174,273
Internally designated for capital improvements	10,748,216	13,768,198
Other long-term investments	1,404,263	1,374,113
Restricted under indenture agreement for debt service (Note 7)	2,195,456	2,393,584
Restricted under indenture agreement for capital assets	3,220,328	-
	<u>\$ 27,935,095</u>	<u>\$ 20,019,220</u>

The breakdown between deposits and investments is as follows:

	2004	2003
Bank deposits (checking and savings accounts)	\$ 6,202,282	\$ 1,288,271
Investments in securities, mutual funds and similar vehicles	21,732,813	18,730,949
	<u>\$ 27,935,095</u>	<u>\$ 20,019,220</u>

At December 31, 2004 and 2003, the Healthcare System had bank deposits as follows:

	2004	2003
Insured (FDIC)	\$ 115,924	\$ 114,777
Collateralized by corporate securities held by the pledging institution in the Healthcare System's name	1,000,000	1,000,000
Uncollateralized	6,089,470	370,330
Total	<u>\$ 7,205,394</u>	<u>\$ 1,485,107</u>
Carrying value	<u>\$ 6,202,282</u>	<u>\$ 1,288,271</u>

Investments are categorized into the following three categories of credit risk:

1. Insured or registered, or securities held by the Healthcare System or its agent in the government's name;
2. Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the government's name; and
3. Uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the Healthcare System's name.

NOTES TO FINANCIAL STATEMENTS

The Healthcare System's investment balances at December 31, 2004 and 2003 were categorized as follows:

December 31, 2004				
	Category			Carrying Amount
	1	2	3	
Risk categorized:				
U.S. Treasury securities	\$ -	\$ 14,833,196	\$ -	\$ 14,833,196
Commercial paper	-	3,367,406	-	3,367,406
Subtotal	<u>\$ -</u>	<u>\$ 18,200,602</u>	<u>\$ -</u>	
Investments not subject to categorization				
Money market funds				<u>3,532,211</u>
				<u>\$ 21,732,813</u>
December 31, 2003				
	Category			Carrying Amount
	1	2	3	
Risk categorized:				
U.S. Treasury securities	<u>\$ -</u>	<u>\$ 14,148,578</u>	<u>\$ -</u>	\$ 14,148,578
Investments not subject to categorization				
Money market funds				<u>4,582,371</u>
				<u>\$ 18,730,949</u>

Investment Income

Investment income and gains and losses on cash equivalents and investments consist of the following for the years ended December 31, 2004 and 2003:

	2004	2003
Interest income and realized gains and losses	\$ 529,791	\$ 615,945
Interest income on proceeds of borrowed funds	199,584	243,232
Total investment income	<u>\$ 729,375</u>	<u>\$ 859,177</u>
Change in unrealized gains and losses on investments	<u>\$ (235,451)</u>	<u>\$ (227,720)</u>

(continued on next page)

NOTES TO FINANCIAL STATEMENTS

NOTE 5 - CAPITAL ASSETS

Capital assets additions, transfers, retirements, and balances for the year ended December 31, 2004 is as follows:

	Balance December 31, 2003	Additions	Transfers and Retirements	Balance December 31, 2004
Capital assets not being depreciated				
Land	\$ 1,643,231	\$ -	\$ -	\$ 1,643,231
Construction in progress	2,046,193	4,117,304	(2,957,571)	3,205,926
Total capital assets, not being depreciated	<u>\$ 3,689,424</u>	<u>\$ 4,117,304</u>	<u>\$ (2,957,571)</u>	<u>\$ 4,849,157</u>
Capital assets being depreciated				
Land improvements	\$ 863,024	\$ 75,000	\$ -	\$ 938,024
Buildings and improvements	34,566,102	460,973	-	35,027,075
Equipment	22,414,968	4,078,834	(314,443)	26,179,359
Total capital assets being depreciated	<u>57,844,094</u>	<u>4,614,807</u>	<u>(314,443)</u>	<u>62,144,458</u>
Less accumulated depreciation for				
Land improvements	(106,141)	(63,501)	-	(169,642)
Buildings and improvements	(8,192,816)	(1,228,215)	-	(9,421,031)
Equipment	(13,877,794)	(2,150,389)	260,414	(15,767,769)
Total accumulated depreciation	<u>(22,176,751)</u>	<u>(3,442,105)</u>	<u>260,414</u>	<u>(25,358,442)</u>
Net capital assets being depreciated	<u>\$ 35,667,343</u>	<u>\$ 1,172,702</u>	<u>\$ (54,029)</u>	<u>\$ 36,786,016</u>
Capital assets, net	<u>\$ 39,356,767</u>	<u>\$ 5,290,006</u>	<u>\$ (3,011,600)</u>	<u>\$ 41,635,173</u>

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NOTES TO FINANCIAL STATEMENTS

Capital asset additions, transfers, retirements, and balances for the year ended December 31, 2003 is as follows:

	Balance December 31, 2002	Additions	Transfers and Retirements	Balance December 31, 2003
Capital assets not being depreciated				
Land	\$ 1,633,291	\$ 9,940	\$ -	\$ 1,643,231
Construction in progress	1,778,492	2,429,761	(2,162,060)	2,046,193
Total capital assets, not being depreciated	<u>\$ 3,411,783</u>	<u>\$ 2,439,701</u>	<u>\$ (2,162,060)</u>	<u>\$ 3,689,424</u>
Capital assets being depreciated				
Land improvements	\$ 159,599	\$ 706,552	\$ (3,127)	\$ 863,024
Buildings	33,901,292	670,470	(5,660)	34,566,102
Equipment	22,662,877	1,897,412	(2,145,321)	22,414,968
Total capital assets being depreciated	<u>56,723,768</u>	<u>3,274,434</u>	<u>(2,154,108)</u>	<u>57,844,094</u>
Less accumulated depreciation for				
Land improvements	(80,042)	(27,406)	1,307	(106,141)
Buildings	(6,980,404)	(1,215,061)	2,649	(8,192,816)
Equipment	(13,391,748)	(2,098,994)	1,612,948	(13,877,794)
Total accumulated depreciation	<u>(20,452,194)</u>	<u>(3,341,461)</u>	<u>1,616,904</u>	<u>(22,176,751)</u>
Net capital assets being depreciated	<u>\$ 36,271,574</u>	<u>\$ (67,027)</u>	<u>\$ (537,204)</u>	<u>\$ 35,667,343</u>
Capital assets, net	<u>\$ 39,683,357</u>	<u>\$ 2,372,674</u>	<u>\$ (2,699,264)</u>	<u>\$ 39,356,767</u>

Construction in progress at December 31, 2004 represents costs related to building and renovation projects and equipment purchased and not placed into service at December 31, 2004. The total estimated cost to complete the projects is \$5,585,000 which will be funded with proceeds from the Hospital Revenue bonds, Series 2004, (Note 7) and internally designated funds.

NOTE 6 - OPERATING LEASES

The Healthcare System leases certain medical and other equipment and office space under operating leases having terms of more than one year. Total operating lease expense in December 31, 2004 and 2003 for all leases was \$460,595 and \$354,365.

NOTES TO FINANCIAL STATEMENTS

Minimum future lease payments for these operating leases are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2005	\$ 299,768
2006	269,206
2007	102,968
2008	71,628
2009	21,928
Total minimum lease payments	<u>\$ 765,498</u>

NOTE 7 - LONG-TERM DEBT

Long-term debt consists of:

	<u>Balance December 31, 2003</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance December 31, 2004</u>	<u>Amounts Due Within One Year</u>
Hospital Revenue Bonds, Series 2004	\$ -	\$ 5,000,000	\$ (30,660)	\$ 4,969,340	\$ 95,521
Hospital Revenue and Refunding Bonds, Series 1999	32,340,000	-	(870,000)	31,470,000	875,000
Original issue discount	(278,183)	-	21,610	(256,573)	-
Equipment note payable	1,435,826	-	(172,412)	1,263,414	177,422
Capitalized lease obligation	104,120	-	(48,056)	56,064	48,055
Unamortized loss on defeasance of Series 1994 Bonds	(3,212,843)	-	249,544	(2,963,299)	-
	<u>\$ 30,388,920</u>	<u>\$ 5,000,000</u>	<u>\$ (849,974)</u>	<u>\$ 34,538,946</u>	<u>\$ 1,195,998</u>

(continued on next page)

NOTES TO FINANCIAL STATEMENTS

	Balance December 31, 2002	Additions	Reductions	Balance December 31, 2003	Amounts Due Within One Year
Hospital Revenue and Refunding Bonds, Series 1999	\$ 33,160,000	\$ -	\$ (820,000)	\$ 32,340,000	\$ 870,000
Original issue discount	(300,356)	-	22,173	(278,183)	-
Equipment notes payable	1,625,609	-	(189,783)	1,435,826	172,414
Capitalized lease obligations	202,002	-	(97,882)	104,120	48,055
Unamortized loss on defeasance of Series 1994 Bonds	(3,468,808)	-	255,965	(3,212,843)	-
Revenue Note	<u>\$ 31,218,447</u>	<u>\$ -</u>	<u>\$ (829,527)</u>	<u>\$ 30,388,920</u>	<u>\$ 1,090,469</u>

Long-Term Debt

The terms and due dates of the Healthcare System's long-term debt, including capital lease obligations, at December 31, 2004 and 2003 are as follows:

- 5.66% Dickinson County Healthcare System, County of Dickinson, State of Michigan, Hospital Revenue Bonds, Series 2004 (Series 2004 Bonds) - due in monthly installments of \$31,194 including interest, to August 2029, secured by certain equipment. (1)
- 5.15% to 5.80% Dickinson County Healthcare System, County of Dickinson, State of Michigan, Hospital Revenue and Refunding Bonds, Series 1999 (Series 1999 Bonds) - Due in varying annual installments to November 2024, secured by a pledge of net revenues, investment income, and bond funds held under the indenture agreement (Note 4). (1)
- Original Issue Discount - Associated with the Series 1999 Bonds issuance.
- Equipment Note Payable - Megavoltage Radiation Therapy (MRT) equipment - During 2000 the Healthcare System entered into a 6%, 10-year note payable with Marquette General Hospital (an unrelated organization) for the purchase of MRT equipment. The note payable is due in monthly installments of \$20,700 to January 2011, and is secured by the MRT equipment
- Capital Lease Obligation - imputed interest rate of 0%, due in monthly installments to February 2006, secured by leased equipment.
- Unamortized Loss on Defeasance of Series 1994 Bonds - During 1999, the Healthcare System defeased the Series 1994 Revenue Bonds by issuing the Series 1999 Bonds. A portion of the Series 1999 Bond proceeds totaling \$32,810,599 was placed in an irrevocable trust to provide for all future debt service payments on the 1994 bonds. Accordingly, the trust accounts' assets and liabilities for the defeased bonds are not included in these financial statements. The resulting loss on defeasance of approximately \$4,480,000 is being amortized using the straight-line method, over the life of the Series 1999 Bonds.

(1) The Series 2004 Bonds and Series 1999 Bonds loan agreements places limits on the incurrence of additional borrowings and requires the Healthcare System satisfy certain measures of financial performance. The Series 1999 Bonds loan agreement also requires the Healthcare System maintain certain deposits with a trustee. Such deposits are shown as restricted for this purpose in the balance sheets (Note 4).

(continued on next page)

NOTES TO FINANCIAL STATEMENTS

Scheduled principal and interest repayments on long-term debt are as follows:

Year Ending December 31,	Long-Term Debt		Total
	Principal	Interest	
2005	\$ 1,195,998	\$ 2,131,495	\$ 3,327,493
2006	1,222,443	2,069,942	3,292,385
2007	1,281,924	2,003,889	3,285,813
2008	1,355,471	1,931,717	3,287,188
2009	1,475,139	1,855,399	3,330,538
2010-2014	7,501,312	8,067,101	15,568,413
2015-2019	9,548,474	5,767,399	15,315,873
2020-2024	12,651,256	2,675,346	15,326,602
2025-2029	1,526,801	213,234	1,740,035
	37,758,818	\$ 26,715,522	\$ 64,474,340
Less unamortized bond discount	(256,573)		
Less unamortized loss on defeasance	(2,963,299)		
Total	\$ 34,538,946		

NOTE 8 - DEFINED BENEFIT PENSION PLAN

A. Plan Description

The Healthcare System is the administrator of a single-employer defined benefit noncontributory pension plan (Plan) covering substantially all of its employees who have met the Plan's eligibility requirements. The Plan was established in 1965 and most recently amended January 1, 2004. The most recent actuarial valuation was made as of January 1, 2005. Based on actuarial information, the Healthcare System's estimated payroll for employees covered by the Plan for the years ended December 31, 2004 and 2003 was \$25,928,000 and \$25,120,000. The Healthcare System's total actual payroll for the years ended December 31, 2004 and 2003 was approximately \$28,160,000 and \$26,731,000.

Current membership in the Plan consists of the following at December 31:

	2004	2003
Retirees and beneficiaries currently receiving benefits	177	177
Vested terminated members	127	109
Active and inactive employees		
Fully vested	497	473
Nonvested	168	199
	969	958

All employees of the Healthcare System are eligible to participate in the Plan following the completion of at least one year of service and a minimum of 1,000 hours. Benefits vest after five years of service and a minimum of 1,000 hours per year.

(continued on next page)

NOTES TO FINANCIAL STATEMENTS

Normal retirement age is 65 with the completion of five or more years of service. Normal retirement pays a monthly pension for life, equal to 1.25% of average monthly compensation per year of credited service plus 0.65% of average monthly compensation in excess of covered compensation per year of service up to a maximum of 35 years, with a \$50 minimum. Employees may elect an early retirement on or after age 60 which pays a monthly pension for life computed in the same manner as a normal retirement pension, but based on service and earnings to date of retirement, and actuarially reduced to reflect the early commencement date.

Active employees with 15 or more years of service and who have attained age 50, who become disabled are eligible for a disability pension, provided they qualify for Social Security disability. A disability pension is computed in the same manner as a normal retirement pension, but based on service and earnings to the date of disability.

If a vested employee dies, a death benefit is paid to the surviving spouse. Fifty percent of the deceased employee's benefit accrued to the date of death, is paid immediately or at the date the employee would have been age 60, whichever is later.

Funding Policy

The Plan's funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are designed to accumulate sufficient assets to pay benefits when due. The required contributions for the years ended December 31, 2004 and 2003 were 5.04% and 4.61%, of annual covered payroll.

Annual Pension Cost

For 2004, 2003, 2002, 2001, and 2000, the Healthcare System's annual pension cost was equal to the Healthcare System's required and actual contributions. The required contribution was determined as part of the January 1, 2004, 2003, 2002, 2001, and 2000, actuarial valuations using the projected unit credit cost actuarial funding method. The actuarial assumptions for fiscal 2004 included (a) 8.5% investment rate of return and (b) salary increases including merit and seniority increases ranging from 0.16% to 3.84% per year, plus wage inflation of 5.0%. The assumptions regarding benefits are that no changes will occur on a postretirement basis.

The Healthcare System's annual pension cost, and required and actual contributions for the years ended December 31, 2004, 2003, 2002, 2001, and 2000 were approximately \$1,267,000, \$1,048,000, \$873,000, \$847,000 and \$732,000. The net pension obligation for the years ended December 31, 2004, 2003, 2002, 2001, and 2000 was zero.

A separately issued financial report of the Dickinson County Healthcare System Retirement Plan is available which includes financial statements and required supplementary information for the Plan.

NOTE 9 - DEFERRED COMPENSATION PLAN

The Healthcare System offers its employees a deferred compensation plan (DC Plan) created in accordance with the Internal Revenue Code, Section 457 and administered by Lincoln Retirement Services Company, LLC (Lincoln). The DC Plan is available to all employees and permits them to defer a portion of their current earnings from income taxes until withdrawal in retirement, upon death, withdrawal upon termination at the employee's option, or withdrawal due to an unforeseeable emergency.

NOTES TO FINANCIAL STATEMENTS

The assets of the DC Plan are held in trust for the exclusive benefit of participants and beneficiaries under the DC Plan, in accordance with Internal Revenue Code, Section 457 (g). Wilmington Trust Company, a Lincoln Affiliate, is the Trustee. Participants or surviving beneficiaries under the DC Plan may allocate their fund balances among independently managed mutual funds Lincoln's Alliance Program and a fixed annuity provided by Lincoln.

In accordance with the provisions of GASB Statement No. 32, the DC Plan assets and activities are not reflected in the financial statements of the Healthcare System.

NOTE 10 - GENERAL AND PROFESSIONAL LIABILITY INSURANCE

The Healthcare System carries general and professional liability insurance through MHA Insurance Company. General and professional liability claims are insured on a claims-made policy covering claims in excess of \$50,000 per occurrence and \$150,000 in the aggregate.

The Healthcare System has exposure to deductibles for professional liability claims and a liability for such claims has been established based upon an actuarial determination of expected losses on an occurrence basis.

The Healthcare System's estimate of general and professional liability includes a provision for known claims and for unreported claims and incidents. The Healthcare System's liability for unreported and known claims and incidents has been recorded at the total of anticipated future payments, and is discounted at present value factors ranging from .834 to .980 for 2004 and .785 to .980 for 2003. Amounts included as expense for general and professional liability for the years ended December 31, 2004 and 2003 were approximately \$606,000 and \$456,000. The reserve for loss on professional liability claims at December 31, 2004 and 2003 and activity for the years then ended is as follows:

Balance December 31, 2002	Additions	Reductions	Balance December 31, 2003	Additions	Reductions	Balance December 31, 2004
\$ 1,350,000	\$ -	\$ (160,000)	\$ 1,190,000	\$ -	\$ (225,000)	\$ 965,000

NOTE 11 - LITIGATION, CLAIMS, AND DISPUTES

The Healthcare System is subject to the usual contingencies in the normal course of operations relating to the performance of its tasks under its various programs. In the opinion of management, the ultimate settlement of litigations, claims, and disputes in process will not be material to the financial position of the Healthcare System.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, specifically those relating to the Medicare and Medicaid programs, can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Recently, federal government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of regulations, which could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenues from patient services. Management believes that the Healthcare System is in substantial compliance with current laws and regulations.

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NOTES TO FINANCIAL STATEMENTS

NOTE 12 - CONCENTRATIONS

The Healthcare System grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. The mix of receivables from third-party payors and patients at December 31, 2004 and 2003 was as follows:

	2004	2003
Medicare	37%	40%
Blue Cross	16%	19%
Medicaid	8%	9%
Commercial insurance and other	22%	20%
Self pay	17%	12%
	<u>100%</u>	<u>100%</u>

The Healthcare System is subject to collective bargaining agreements for approximately 64 percent of its labor force. These agreements are negotiated on a tri-annual basis. The agreement for the Michigan Nurses Association will expire in May of 2005. This agreement is currently under negotiation. The agreement for the American Federation of State, County, and Municipal Employees (AFSCME) will expire in December of 2006.

NOTE 13 - DICKINSON COUNTY HOSPITAL FOUNDATION

Dickinson County Hospital Foundation (Foundation) is organized to raise funds for the benefit of the Healthcare System and the community. The Foundation is deemed not to be a component unit of the Healthcare System as defined in GASB 39, *Determining Whether Certain Organizations Are Component Units*, as the economic resources received or held by the Foundation is not considered significant to the Healthcare System. As the Foundation is not considered a component unit, the Foundation's financial statements are not included in these financial statements. At December 31, 2004 and 2003, the Foundation's assets consisted primarily of cash and short-term investments and totaled approximately \$447,000 and \$365,000. During 2004 and 2003, the Foundation transferred funds totaling \$100,000 and \$15,000 to the Healthcare System. These amounts are included in capital contributions on the accompanying financial statements.

NOTE 14 - FORWARD PURCHASE CONTRACT/DEFERRED GAIN

A forward purchase contract was entered into in 1999 by the Healthcare System relating to certain trustee held funds associated with the Series 1999 bonds. The contract provides a fixed rate of return of 5.775% on the Debt Service Fund and the Reserve Fund investments (Note 4).

The contract has a maturity date of November 2024, a notional value of \$2,864,000 and \$2,859,942 as of December 31, 2004 and 2003, respectively, and an estimated fair value of \$330,000 and \$268,000 at December 31, 2004 and 2003, respectively.

Upon inception of the agreement, the Healthcare System received a premium of \$220,000 from the counter party, which is being amortized over the life of the debt, and is recorded as a deferred gain.

The Healthcare System believes its credit risk is minimal on the transaction.



**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

To the Board of Trustees of
Dickinson County Healthcare System

We have audited the financial statements of the Dickinson County Healthcare System (the "Healthcare System") (a component unit of Dickinson County) as of and for the year ended December 31, 2004, and have issued our report thereon dated April 2, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

COMPLIANCE

As part of obtaining reasonable assurance about whether the Healthcare System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances on noncompliance that are required to be reported under *Government Auditing Standards*.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered that Healthcare System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the Healthcare System in a separate letter dated April 6, 2005.

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3203 32nd Ave. SW ■ PO Box 2905 ■ Fargo, North Dakota 58108-2905 ■ Phone 701.239.8500 ■ Fax 701.476.8400 ■ EOE

This report is intended solely for the information and use of the Board of Trustees, management of the Healthcare System and the State of Michigan and is not intended to be and should not be used by anyone other than these specified parties.

Eide Bailly LLP

April 6, 2005
Fargo, North Dakota